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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

November 30, 1999

Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth St., S.W.
Washington, D.C. 20554

Re: Merger of Qwest Communications International Inc. and U S WEST, Inc., CC Docket No. 99-272

Dear Ms. Salas:

On behalf of Qwest Communications International Inc. ("Qwest") and U S WEST, Inc. ("U S WEST") (collectively, the "Applicants"), this letter responds to a letter from Randall Rings, Vice President and General Counsel, McLeodUSA Telecommunications Services, Inc. ("McLeod"), dated November 12, 1999 ("Nov. 12 Letter"). The Commission should reject McLeod's unsupported *ex parte* contentions, and should proceed with an expeditious review and approval of the proposed transaction. In this letter, we demonstrate, contrary to McLeod's assertions, that: (1) the merger will advance the public interest; (2) arguments regarding U S WEST's interconnection and service quality are misplaced; (3) the merger will have no negative effect on out-of-region competition; (4) the merger will not facilitate predation or cross-subsidies; and (5) McLeod's proposed conditions are inappropriate.

1. The Merger Will Advance The Public Interest. In the letter, McLeod argues, first, that the Applicants "have not placed on the record enough information to determine whether the merger is in the public interest." Nov. 12 Letter at 2. McLeod's assertion ignores the detailed information that the Applicants have already submitted on this subject. We have shown that the merger will have no adverse competitive impacts, and will advance the public interest by enabling the merged company to accelerate deployment of advanced services and to compete more vigorously, and by creating stronger incentives for the merged company to demonstrate that it has satisfied the Section 271(d) checklist, and thereby enter the in-region interLATA marketplace. *See* Petition at 11-18; Applicants' Reply Comments at 11-23 & Attachment A (Declaration of Dennis W. Carlton and Hal S. Sider) and Attachment B (Declaration of Bruce M. Owen). Similarly, McLeod's naked assertion that the Qwest Divestiture Plan is "fraught with loopholes" that enable the company prematurely to provide "in-region bundled local and interLATA services," Nov. 12 Letter at 2, is baseless and contradicted

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by ample evidence in the record. 1/ In short, McLeod can point to no "loopholes," for there are none. 2/

2. McLeod's Arguments Regarding U S WEST Interconnection and Service Quality Are Misplaced. Second, McLeod argues that "U S WEST's record as a provider of wholesale inputs to CLECs . . . has been terrible." Nov. 12 Letter at 2. The Applicants have clearly shown that this proceeding is not the proper forum to resolve such allegations, Applicants' Reply Comments at 23-29, and McLeod adds nothing new in the letter. Alleged U S WEST misconduct or service quality problems should be addressed in state or federal proceedings directed to those matters. Indeed, complaints concerning interconnection disputes and local service quality do not bear on the merger in any way. Neither McLeod nor any other party has shown how consummation of the merger would create (or exacerbate) any of the interconnection or service-quality issues that have been asserted in this proceeding. Rather the grievances raised here predate the merger, and accordingly would exist in the absence of consummation of the proposed transaction.

1/ Qwest has made it absolutely clear that the sale of its in-region interLATA business to an independent carrier or carriers ("Buyer") will be final and irrevocable upon consummation of the merger. *See* Qwest Divestiture Plan (Attachment C to the Applicants' Reply Comments) at 2. Qwest has also made it clear that any support functions it provides to the Buyer will *not* include interLATA telecommunications, and will have no unique or discriminatory relationship with U S WEST's local exchange operations. Moreover, any such support services will be transparent to customers so as to avoid creating a mistaken impression that Qwest is continuing to provide in-region interLATA services post-merger. *Id.* at 6-11; *see also* Qwest Response to Staff Request for Information and Documents (attached to letter from Linda L. Oliver, Counsel for Qwest, to Magalie Roman Salas, Secretary, dated Nov. 24, 1999) at 1-5.

2/ As an attachment to its Nov. 12 Letter, and at the request of the staff, McLeod submits a copy of a letter from a Qwest attorney to a company affiliated with McLeod. First, Qwest has previously indicated that certain statements in that letter do not correctly reflect Qwest's plans with respect to divestiture. *See* Applicants' Reply Comment at 37 n.83. To be clear, Qwest will divest both its prohibited wholesale and retail in-region interLATA services. While Qwest has not begun to divest these in-region services and customers, it will have completed such divestiture prior to closing. More to the point, it is curious that McLeod continues to point to that letter given its subject matter – McLeod's own misleading marketing activities to Qwest customers based on McLeod's own erroneous statements regarding the timing and nature of Qwest's divestiture. In light of McLeod's persistent reference to this matter, Qwest is pleased that the Commission staff requested McLeod to put the entire letter into the record, rather than simply refer to excerpts taken out of context.

McLeod raises the unfounded assertion that the merged company's plan to "slash the U S WEST dividend and to redeploy the $5.3 of resulting 'savings' to non-ILEC investments" could create risks that allegedly could lead to higher rates or degraded service. Nov. 12 Letter at 4. First, price cap regulation of U S WEST renders this argument irrelevant. Second, whether the company uses its earnings to issue dividends or to reinvest could not possibly affect U S WEST's rate levels or its use of available capital to maintain and improve service quality. Third, if anything, the merger will lead to improved, not degraded service quality. Because one of the principal objectives of this transaction is to create a formidable competitor to the new ILEC-ILEC combinations, the merged company will have an increased incentive to enhance the quality of its local services in order to compete for local customers everywhere.

In addition, the service-quality grievances advanced in this proceeding generally are being reviewed in state proceedings, with respect to this merger and otherwise. Indeed, redress of the service-quality concerns raised here is more appropriate at the local level, and U S WEST has begun working at the state level to address these concerns, outside the merger context entirely. 3/

3. The Merger Will Have No Negative Effect On Out-Of-Region Competition. McLeod's third argument – and the primary focus of its *ex parte* letter – raises the spectre that the merger (and the resulting position of the merged company in the out-of-region interexchange marketplace) could somehow harm out-of-region competitors. Yet McLeod simply ignores that these same arguments already were considered and rejected by the Commission over two and a half years ago.

3/ U S WEST invests approximately $2.5-3.0 billion annually in its network to meet the growing demand for its local services and to assure that its services will be of the high quality that its customers have a right to expect. While U S WEST has recently acknowledged certain shortcomings in service-quality, the company has initiated the most aggressive service initiative in its history. *See U S WEST Service Improvement Initiative*, Press Release, www.uswest.com/about/programs/service, (October 25, 1999). As part of this initiative for 1999, the company has committed to investing over $4 billion, or an additional $1.1 billion this year compared to 1998, to further improve its local network infrastructure, including an aggressive upgrade of its Central Office systems.

Specifically, McLeod attempts to argue that the merger will increase U S WEST's incentive "to degrade terminating access (for all IXCs except Qwest) because such behavior will make it more likely that customers outside of the U S WEST region will choose Qwest as their long distance carrier." Nov. 12. Letter at 3. These arguments (and similar ones) have already been presented to the Commission, and the Commission flatly rejected them:

> [A]lthough a BOC or an independent LEC may control the facilities used to terminate its interexchange competitors' calls in its in-region service area, we believe it has less opportunity to discriminate against competitors through its control of these facilities. In order to discriminate effectively through control of terminating exchange access, the BOCs and independent LECs would have to convince consumers that an inferior termination connection was the fault of their interexchange carrier, and that the only way to obtain efficient termination arrangements to this region would be through the BOCs' or independent LECs' interexchange services. In addition, to the extent such quality degradation is apparent to consumers, it is also likely to be apparent to regulators and interexchange competitors. * * * * We, therefore, conclude that discrimination by a BOC or an independent LEC is unlikely in the context of out-of-region, interstate, interexchange services.

Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area; Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756, ¶ 208 (1997) ("*Regulatory Treatment Order*"); *see id. at* ¶¶ 206-213 (concluding that ILECs may provide out-of-region interexchange services as non-dominant carriers, without any structural separation or other safeguards).

McLeod raises the even more far-fetched argument that "U S WEST will be able to capture a greater proportion of the benefits of discriminating against CLECs entering its region because such discrimination will harm those CLECs' ability to compete with Qwest's high-speed local access and Internet access operations outside of the U S WEST region." Nov. 12. Letter at 3. If the Commission were to accept this argument, it would have to discourage, or impose restrictions upon, ILEC affiliates' provision of competitive local service outside their home regions But to the contrary, the Commission has imposed no restrictions on ILEC affiliates' provision of local service, and has strongly encouraged ILECs to enter markets outside their home territories. *See, e.g., Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order, 11 FCC Rcd 21905, ¶ 315 (1996) ("We also conclude as a matter of policy that regulations prohibiting BOC section 272 affiliates from offering local exchange service do not serve the public interest."); *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee*, CC Docket No. 98-141, FCC 99-279, ¶ 398 (released Oct. 8, 1999) ("[R]esidential consumers and business customers outside of SBC/Ameritech's territory [will] benefit from facilities-based competitive service by a major incumbent LEC.").

4. The Merger Will Not Facilitate Predation or Cross-Subsidies. The Commission has also rejected the argument, now raised again by McLeod, that "the merged firm's opportunities to engage in predation will be much greater than is currently the case" by making it "more difficult for regulators to ensure that the ILECs receive adequate resources to provide retail and wholesale service at an acceptable level of quality." Nov. 12 Letter at 3. Specifically, the Commission held that "the geographic separation between a LEC's in-region local exchange and exchange access operations and out-of-region long distance operations mitigates the potential for undetected improper allocation of costs." *Regulatory Treatment Order*, ¶ 209. The Commission also found that "statutory and regulatory safeguards, including our Part 64 rules, * * * * are sufficient to prevent the BOCs and independent LECs from improperly allocating costs." *Id.* The Commission further determined that the incentives created by price cap regulation reduce the potential for such behavior. *Id.* The Commission concluded that these factors, as well as the facts that "the BOCs and independent LECs do not have control over originating exchange access for out-of-region, interstate, interexchange services" and that "typically a BOC's originating out-of-region calls that terminate in-region will account for a small percentage of the BOC's total out-of-region originating traffic," mean that ILECs "will not be able to engage in a price squeeze" -- *i.e.*, predatory pricing. *Id.*, ¶ 210.

5. McLeod's Proposed Conditions Are Inappropriate. Finally, McLeod argues that the Commission should impose an assortment of conditions upon the merged company, including "substantive performance benchmarks, reporting requirements and penalties to ensure that U S WEST ILECs provide adequate wholesale service," unique "procedural mechanisms," and "special arbitration procedures." Nov. 12 Letter at 4. But in the absence of any showing that the proposed transaction would thwart the public interest, generic rules of conduct that McLeod and others seek to impose on the Applicants should be addressed in generic proceedings. Indeed, the Applicants have shown that the transaction will create powerful new incentives for U S WEST to comply with the Section 271 checklist requirements and obtain in-region authority, to remedy the difficulties that the merged company will have in providing long-distance service to "a doughnut-shaped footprint with a 14-state hole," Applicants' Reply Comments at 18, and to take full advantage of the national interLATA network that it will continue to own. *See id.* at 18-23 & Attachment B. The Applicants have demonstrated that the proposed merger will produce substantial procompetitive benefits and no significant anticompetitive harms.

Under the legal standard governing the Commission's merger review authority, conditions such as those proposed by McLeod are out of place. Congress invested the Commission with limited authority to attach conditions to its approval of merger transactions. Section 214(c) of the Communications Act permits the Commission to attach to a certificate only "such terms and conditions as . . . the public convenience and necessity may require." 47 U.S.C. § 214(c). Likewise, section 303(r) of the Act restricts the Commission to "prescrib[ing] such restrictions and conditions . . .*as may be necessary* to carry out the provisions of the chapter." 47 U.S.C. § 303(r) (emphasis added). The Commission has consistently interpreted these provisions as authorizing it to attach conditions to a merger only "where necessary . . . to ensure that the public interest is served by the transaction." *Applications for Consent to Transfer of Control of Licenses from TCI to AT&T*, 14 FCC Rcd 3160, ¶ 15 (1999); *Applications for Consent to Transfer Control of Licenses from MCI Communications to WorldCom, Inc.* ("*MCI WorldCom Order*"), 13 FCC Rcd 18025, ¶ 10 (1998); *Applications of NYNEX Corporation and Bell Atlantic Corporation* ("*BA-NYNEX Order*"), 12 FCC Rcd 19985, ¶ 30 (1997). Accordingly, any condition imposed on a merger transaction must address a specific anticompetitive risk or harm *created by the transaction.*

It is well-established that the Commission may not use its merger review authority as an opportunity to impose obligations on the merger parties that are not related to issues raised by the merger. *See Bell Atlantic-NYNEX* at ¶ 220 (Commission does not impose merger conditions "that are not related to . . . potentially harmful effects of the merger"); *AT&T-TCI Order* ¶ 429 ("conditions . . . are targeted at the types of discrimination the merger was otherwise most likely to engender"); *Telecommunications, Inc. and Liberty Media Corporation*, 9 FCC Rcd 4783, ¶ 117 (1994) ("[t]here is no need to impose a merger condition . . . for an alleged harm that is not traceable to the merger"). In the recent AT&T-TCI, MCI-WorldCom, and Bell Atlantic-NYNEX merger proceedings, for example, the Commission consistently refused to impose conditions not directly related to anticompetitive risks or harms created by those transactions. In the AT&T-TCI proceeding, the Commission refused to impose a condition granting competitors a right of access to the merged company's multichannel video programming facilities in light of its conclusion that the merger would be "unlikely to result in the loss of a significant source of current or future competition in MVPD services." *AT&T-TCI Order* at ¶ 22. Similarly, in light of the Commission's determination that the MCI-WorldCom merger was "not likely to have anticompetitive effects on the provision of . . . private line service on any U.S. international route," it refused to condition its approval on a divestiture of any such facilities. *MCI WorldCom Order* at ¶ 135. Finally, the Commission concluded that the Bell Atlantic-NYNEX merger proceeding was "not the appropriate forum" for the attachment of conditions relating to Bell Atlantic's minority and small business contracting practices because such conditions would not "remedy . . . potential harms to competition that [would] result from the merger." *Bell Atlantic-NYNEX* at ¶ 220, 226. The same principle clearly applies here.

In sum, McLeod's further *ex parte* arguments against the proposed merger are unsupported and reflect advocacy that the Commission has consistently rejected when there is no showing of competitive harm. The Commission should reject McLeod's and other commenters' demands for conditions and should proceed to approve the transaction expeditiously.

Respectfully submitted,

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